IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF IOWA
EASTERN DIVISION

RICHARD L. McGOWAN, LTD., INC., Plaintiff, vs. SOY BASICS, L.L.C., Defendant.	No. C06-2064 **ORDER FINDING BREACH OF CONTRACT**

TABLE OF CONTENTS

I. INTRODUCTION

On the 11th day of September 2007, this matter came on for trial to the Court on the Amended Complaint (docket number 64) filed on January 16, 2007, and the Counterclaim (docket number 71) filed on March 12, 2007. Plaintiff Richard L. McGowan, Ltd., Inc., was represented by its President, Richard L. McGowan, and its attorney, Matthew L. Preston. Defendant Soy Basics, LLC was represented by its Acting President, Jon Nicolaisen, and its attorneys, David J. Dutton and Michael R. Young.

II. PROCEDURAL HISTORY

On March 17, 2005, Plaintiff Richard L. McGowan, Ltd., Inc. ("McGowan") filed a Complaint (docket number 65) in the Franklin County, Ohio, Court of Common Pleas, requesting judgment against Defendant Soy Basics, LLC ("Soy Basics"). McGowan claimed entitlement to recover for breach of contract, unjust enrichment, violation of Ohio Revised Code Section 1335.11, and tortious interference with a contract. On May 9, 2005, Soy Basics filed its Answer and Counterclaim (docket number 66). Soy Basics denied McGowan's substantive allegations, and claimed that it was entitled to recover for McGowan's failure to return "equipment" to Soy Basics following McGowan's termination.

On April 25, 2005, the action was removed from the State Court in Ohio to the United States District Court for the Southern District of Ohio. On September 5, 2006, the United States District Court in Ohio ordered that the case be transferred to the United States District Court for the Northern District of Iowa. *See* Opinion and Order (docket number 42-72). On January 16, 2007, Plaintiff filed its Amended Complaint (docket number 64). In its Amended Complaint, Plaintiff dropped its claim of tortious interference with a contract, but pleading in the alternative, added a claim for violation of Iowa Code Chapter 91A. On March 12, 2007, Defendant answered and renewed its Counterclaim (docket number 71).

III. RELEVANT FACTS

A. The Parties

Plaintiff Richard L. McGowan, Ltd., Inc., ("McGowan") is a small company owned and operated by Richard L. McGowan and his wife, Carol McGowan. McGowan acts as a manufacturer's representative, selling "housewares and gift ware, crystal, decorative accessories, [and] some furniture" to retail stores. McGowan operates a showroom at the Columbus Marketplace in Columbus, Ohio, and also employs salesmen to work "on the road."

Defendant Soy Basics, L.L.C. ("Soy Basics") is a closely-held corporation in New Hampton, Iowa, which manufactures soy candles. Jon Nicolaisen, Soy Basics' Acting President, testified that he owns fifty percent of the business and Mark Kramer owns the remaining fifty percent. Nicolaisen estimated that in October 2004, approximately ninety percent of Soy Basics' sales were made through independent representatives such as McGowan.

B. The Agreements

During the latter part of 2001, McGowan was contacted by Kimberly Shaw, who at that time was national sales manager for Soy Basics. Shaw had apparently heard of McGowan's reputation as a manufacturer's representative and asked if it was interested in representing Soy Basics. Richard McGowan testified that he "liked what she was saying about the product" and was highly interested in representing Soy Basics. On November 19, 2001, the parties executed an Independent Sales Representative Agreement (Plaintiff's Exhibit 1), wherein McGowan agreed to solicit orders for Soy Basics products in exchange for a fifteen percent commission.[1] McGowan testified that "we believed in the product" and the parties initially had a very good relationship.

[1]Inexplicably, pages 6-8 of the 10-page Agreement are omitted from the Exhibit. Apparently, neither party was able to find the complete Agreement.

Initially, McGowan represented Soy Basics in Ohio, Indiana, Kentucky, West Virginia, and Western Pennsylvania. McGowan's "territory" was cut back, however, and by the summer of 2004, it represented Soy Basics in Ohio only. According to Nicolaisen, the other states were taken away because Soy Basics believed it could improve its performance in those states by contracting with other representatives.

In the summer of 2004, Soy Basics sent McGowan a new Sales Representative Agreement (Plaintiff's Exhibit 2), which changed some of the terms of the Agreement and limited the sales territory to Ohio, but maintained the basic commission rate of fifteen percent. Richard McGowan testified that when the proposed new Agreement was received as an e-mail attachment, he printed it out, made changes, and "sent it back for approval in writing." The changes made by McGowan prior to returning the Agreement are identified in Plaintiff's Exhibit 3. Among other things, the proposed Agreement submitted by Soy Basics provided in Paragraph 6(e) of Schedule A of the Agreement that "termination by Company for cause, or by Representative, shall cancel all unpaid commissions." That provision was deleted by McGowan prior to the Agreement being signed and returned.[2] Richard McGowan signed the Amended Agreement, apparently on or about August 12, 2004, and returned the document to Soy Basics.

Richard McGowan testified that he did not have any communication with Soy Basics regarding the proposed Agreement (Exhibit 2) from the time it was first received, until he signed and returned the modified Agreement (Exhibit 4). In fact, McGowan testified that he heard nothing from Soy Basics about the Agreement until after McGowan was terminated as a representative of Soy Basics on October 26, 2004.

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[2]There are other unexplained changes in the Agreement. For example, the original proposed Agreement (Exhibit 2) does not include paragraph 6(f) in Schedule A, while Exhibit 3 (which purports to show the changes made by McGowan to the original proposed Agreement) includes paragraph 6(f). Furthermore, paragraph 6(f), which imposes additional duties on McGowan, is included in the final Agreement identified as Exhibit 4. Also, paragraph 9.2 (which was deleted altogether by McGowan before returning the document) is different on Exhibits 2 and 3.

Tim Knowles, who at that time was national sales manager of Soy Basics, testified that on October 26, 2004, he hand-delivered a letter to McGowan at his showroom in Columbus, Ohio, terminating the agreement between the parties. The first paragraph of the letter provides:

> We have been given credible information that you are in violation of the Rep Agreement that you entered with Soy Basics on August 12, 2004 as a result of representing and selling candles of a competitor and diverting business from Soy Basics to the competitor.

See Plaintiff's Exhibit 5.

Richard McGowan testified that he had some expectation that the parties' relationship would be terminated. According to McGowan, Tom Clark, who was Vice-President of Sales and Marketing for Soy Basics, told McGowan that he was insulted by McGowan hiring a salesman in Pennsylvania that Clark had let go. According to McGowan, Clark told him that "he would get even with me on it." The record is imprecise, however, regarding when that exchange allegedly took place.

A few weeks after the relationship between the parties was terminated on October 26, 2004, McGowan received, for the first time, a copy of the August 12, 2004, Agreement (Exhibit 4). The Agreement indicates it was accepted by "T. Clark" on behalf of Soy Basics on September 8, 2004. On the first page of the Agreement, the "term of agreement" is extended from "one year" to "12/31/06." The initials "T.C." appear by the modification.

C. The Dispute

It is undisputed that before taking any deductions, offsets, or credits, Soy Basics owes McGowan $13,174.62 for unpaid commissions earned prior to the termination of the Agreement between the parties. Soy Basics claims that it is entitled to offsets for bad debts and unreturned materials, however, thereby reducing the amount owed to $6,209.66. Nothing has been paid on the amount which Soy Basics admittedly owes.

While the parties had an ongoing relationship, the commissions earned on sales during the preceding month were generally paid around the fifteenth of the next month. If the sale was cancelled because the retailer was not credit worthy, or if the amount was uncollectible as a bad debt, then an adjustment was made in subsequent commission payments to McGowan. Jon Nicolaisen testified a "general accounting" was required after McGowan's termination in order to determine the precise amount owed. According to Nicolaisen, however, Soy Basics received a demand letter from McGowan's attorney which far exceeded the amount owed and therefore nothing was paid. Nicolaisen insisted, however, that Soy Basics has been ready, willing and able to pay the net commissions owed to McGowan.

Among other things, Soy Basics claims that McGowan is required to pay for samples which were provided for its showroom and its salespersons. Following the termination of the agreement between the parties, McGowan delivered the display hutches to Soy Basics' new manufacturer's representative (who was apparently located just across the hall at the Columbus Marketplace). Richard McGowan testified, however, that they disposed of the sample candles. According to McGowan, some of the candles were given to charity, although the evidence also suggested that some may have been sold at a "samples sale." In any event, McGowan denies that it was required under the Agreement to return the samples to Soy Basics.

Jon Nicolaisen testified (after having his recollection refreshed by reviewing his own answers to interrogatories) that the value of samples sent in 2003 totaled approximately $1,500, the samples sent in 2004 totaled $1,700, and approximately $500 worth of samples were sent in 2004 for a trade show. Nicolaisen was unable to testify, however, regarding the samples which remained on October 26, 2004, or their approximate value. Tim Knowles, who delivered the termination letter to McGowan on October 26, 2004, testified that he saw the hutches and candles in McGowan's showroom, but did not make any inventory and did not discuss the disposition of the candles with McGowan.

IV. ANALYSIS

A. Which Agreement Applies?

Preliminarily, the Court must determine whether the agreement between the parties is defined by the Independent Sales Representative Agreement (Plaintiff's Exhibit 1) executed on November 19, 2001, or the Sales Representative Agreement (Plaintiff's Exhibit 4) signed by Richard McGowan on August 12, 2004 and apparently signed by Tom Clark (on behalf of Soy Basics) on September 8, 2004.

It is undisputed that the parties entered into an agreement (Plaintiff's Exhibit 1) on November 19, 2001. Some time during the summer of 2004, however, Soy Basics sent McGowan a proposed new Agreement (Plaintiff's Exhibit 2).[3] The proposed new Agreement differed significantly from the 2001 Agreement in several respects relating to termination of agreement: First, paragraph 8 provided that upon termination of the Agreement, McGowan was required to "return and transport at its own expense all materials in its possession or control" which relate to Soy Basics business; second, paragraph 9.2 prohibited McGowan from diverting or attempting to divert any business from Soy Basics for a period of eighteen months following termination of the agreement; and third, paragraph 6(e) of Schedule A provided that "[t]ermination by Company for cause, or by Representative, shall cancel all unpaid commissions."[4]

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[3]While Richard McGowan testified that he received the proposed Agreement as an attachment to e-mail, the record is imprecise regarding when that e-mail was received. McGowan testified that he was "not sure" how long he had the proposed Agreement before modifying and returning it, but it was "probably less than a month." Carol McGowan estimated that they had the proposed Agreement for three or four weeks before sending it back, although she was "not sure exactly."

[4]The Court notes parenthetically that there is evidence which suggests that the proposed new Agreement was sent to McGowan in anticipation of Soy Basics terminating their agreement. In an e-mail (Plaintiff's Exhibit 11) from Tim Knowles to Jon Nicolaisen and Tom Clark, dated July 29, 2004, Knowles refers sarcastically to an e-mail from McGowan regarding plans for sales and new accounts during 2004 and 2005. Knowles then reports that they have found others with "the type of coverage and commitment we

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Under Iowa law, the elements of a valid contract are offer, acceptance, and consideration. *Owen v. MBPXL Corp*, 173 F. Supp. 2d 905, 914 (N.D. Iowa 2001) (citing *Taggart v. Drake University*, 549 N.W.2d 796, 800 (Iowa 1996) and *McBride v. City of Sioux City*, 444 N.W.2d 85, 91 (Iowa 1989)). *See also Tralon Corp. v. Cedarapids, Inc.*, 966 F. Supp. 812, 822 (N.D. Iowa 1997). Stated otherwise, all contracts must contain mutual assent. *Hawkeye Commodity Promotions, Inc. v. Miller*, 432 F. Supp. 2d 822, 844 (N.D. Iowa 2006) (citing *Magnusson Agency v. Pub. Entity Nat'l Co.--Midwest*, 560 N.W.2d 20, 26 (Iowa 1997)). "This assent is usually given through an offer and acceptance." *Id.*

In this case, Soy Basics sent a proposed new agreement to McGowan in the summer of 2004. Rather than accepting the agreement as proposed, however, McGowan made substantive changes before signing and returning the document. Upon receipt of the modified document, Tom Clark signed the agreement on behalf of Soy Basics, but altered the "term of agreement" from "one year" to "12/31/06." McGowan was not notified that the Agreement had been accepted (as modified), however, until November 2004 (a couple of weeks after Soy Basics terminated the agreement).

1. Offer and Acceptance.

It is undisputed that McGowan did not accept the contract offered by Soy Basics, as set forth in Plaintiff's Exhibit 2. Rather, McGowan made a number of substantial changes to the document, signed it, and returned the modified document to Soy Basics. Accordingly, the contract returned by McGowan constituted a counter-offer. *See Restatement (Second) of Contracts* § 39 (1981). Prior to signing the document on behalf of Soy Basics, however, Clark extended the term of the agreement from one year to

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[4](…continued)
expect" and therefore they "will be heading in that direction." The e-mail concludes:

> So perhaps on August 15th we will no longer be represented by McGowan. If we are all in agreement I will draft a 1 page letter to that effect next week. Let me know your thoughts and ideas.

December 31, 2006 (approximately twenty-eight months). The issue before the Court is whether Clark's modification converted Soy Basics' purported acceptance to a counter-offer. *See Restatement (Second) of Contracts* § 59 (1981).

The so-called "mirror image" rule reflected by Section 59 of the *Restatement (Second)* was described by the Iowa Supreme Court in *Shell Oil Co. v. Kelinson*, 158 N.W.2d 724 (Iowa 1968), as follows:

> The rule is well settled that in a contract by offer and acceptance, the acceptance must conform strictly to the offer in all its conditions, without any deviation or condition whatever.

Id. at 728. *See generally*, 1 *Corbin on Contracts* §§ 3.28 and 3.35 (rev. ed.); and 2 *Williston on Contracts* § 6:1 and 6:10 (4th ed.). Soy Basics argues in its post-trial brief that while the mirror image rule was "once the law," the adoption of the Uniform Commercial Code in Iowa "changed all this in the case of merchants."[5] Soy Basics cites Iowa Code Section 554.2207 for the proposition that "A merchant can accept an offer through a response that is not a 'mirror image' so long as the response does not 'materially alter' the terms of the offer."[6] Soy Basics then argues that both parties are "merchants" within the meaning of the Uniform Commercial Code and, therefore, Soy Basics accepted McGowan's counter-offer, notwithstanding the modification made by Clark.

It is true that Article 2 of the Uniform Commercial Code "relaxes many of the legal formalisms and technicalities of contract formation associated with the common law of contracts." *Flanagan v. Consolidated Nutrition*, 627 N.W.2d 573, 578 (Iowa App. 2001). Soy Basics' argument fails, however, because the contract in dispute does not involve a transaction in goods. *See* Iowa Code § 554.2102 ("unless the context otherwise requires, this Article applies to transactions in goods."). McGowan and Soy Basics were not contracting for the purchase or sale of goods, but rather were contracting for the services

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[5] *See* Defendant/Counterclaim Plaintiff's Supplemental Trial Brief (docket number 88) at 4.

[6] *Id.*

of McGowan in exchange for compensation. The Uniform Commercial Code does not apply to services. *Moore v. Vanderloo*, 386 N.W.2d 108, 112 (Iowa 1986).

The Court concludes that the common law mirror image rule applies to the proposed new agreement between the parties. When McGowan signed the modified agreement and returned it to Soy Basics, it constituted a counter-offer. Tom Clark's purported acceptance of the counter-offer was ineffective, however, because he modified the length of the agreement. The document then became Soy Basics' counter-offer to McGowan's counter-offer, and would not be effective unless accepted by McGowan. It was not accepted by McGowan (nor even communicated to McGowan until after its termination) and, therefore, was never effective.

2. Notice of Acceptance.

As set forth above, the Court has concluded that Soy Basics did not effectively accept the counter-offer made by McGowan. Even if the acceptance was otherwise valid, however, Soy Basics failed to notify McGowan of its acceptance of the counter-offer. Generally, notice of acceptance is required in order to establish a binding agreement. *See Restatement (Second) of Contracts* § 56 (1981). Mere acceptance of an offer does not necessarily make a binding contract; the acceptance must be communicated to the offeror. *Heartland Express, Inc. v. Terry*, 631 N.W. 2d 260, 270 (Iowa 2001). "A mere private uncommunicated assent will not effect a contract." 17A Am. Jur. 2d *Contracts* § 71, at 95 (1991) (cited with approval in *Heartland Express*, 631 N.W.2d at 270). *See also* 1 *Corbin on Contracts* § 3.13 (rev. ed.).

In this case, Tom Clark apparently signed the Sales Representative Agreement (Plaintiff's Exhibit 4) on behalf of Soy Basics on September 8, 2004. That purported acceptance was not communicated to McGowan, however, until several weeks after McGowan was terminated as a representative of Soy Basics on October 26, 2004. Accordingly, the Court concludes that the proposed new agreement also fails due to lack of notification of the purported acceptance by Soy Basics.

B. Breach of Contract

1. McGowan's Claim.

In Count I of its Amended Complaint (docket number 64), McGowan claims entitlement to recover for breach of contract. As set forth above, the Court has concluded that the agreement between the parties is represented by the Independent Sales Representative Agreement (Plaintiff's Exhibit 1) executed on November 19, 2001. The Agreement provides generally that McGowan will solicit orders for Soy Basics products and, in consideration for its services, be paid a commission of fifteen percent on sales. It is undisputed that before taking any deductions, offsets, or credits, Soy Basics owes McGowan $13,174.62 for unpaid commissions earned prior to the termination of the agreement between the parties. Soy Basics has failed to pay McGowan for earned commissions and, therefore, is in breach of the contract.

2. Soy Basics' Counterclaim.

In its Counterclaim filed on May 9, 2005 (docket number 42-14), as renewed on March 12, 2007 (docket number 71), Soy Basics claims entitlement to judgment against McGowan due to McGowan's failure to return "equipment [provided] to use in the sale of Soy Basics products." At the time of trial, however, Soy Basics based its counterclaim on McGowan's failure to return sample candles.

The Court concludes that Soy Basics failed to prove its entitlement to recover on its Counterclaim. The agreement between the parties is represented by the Independent Sales Representative Agreement executed in 2001. That Agreement provides, in part, as follows:

> Company shall provide Two Hundred Dollars ($200.00) worth of samples (excluding freight) deemed necessary by Representative for use by its sales force and in its showrooms for each year of this agreement to Representative free of charge. Representative shall pay fifty percent of the wholesale costs of any additional samples deemed necessary by Representative. Company shall pay all shipping charges for samples between Representative and Company. *McGowan Ltd should have sufficient samples to properly display the line in*

> *the showroom. All showroom samples are no charge all freight free. McGowan Ltd is not responsible for the cost of salesmen samples.*[7]

Accordingly, the agreement reached between the parties in 2001 anticipated that McGowan would be provided "sufficient samples to properly display the line in the showroom" at "no charge." The candles which Soy Basics claims constitute the basis of its Counterclaim are those candles which were in McGowan's showroom at the time it was terminated. The parties agreed in 2001 that those candles would be provided at no charge.[8]

Even if the agreement between the parties otherwise provided for payment by McGowan for showroom samples, the Court concludes that Soy Basics failed to meet its burden of proof in this regard. While Jon Nicolaisen testified that $3,700 worth of samples were sent to McGowan in 2003 and 2004, he did not know how many samples remained when the agreement was terminated on October 26, 2004. Nicolaisen admitted that some of the samples were intended to be burned or otherwise used to promote sales. In addition, the evidence established that some of the candles lost their color and were, therefore, worthless. While Tim Knowles observed candles in McGowan's showroom when he delivered the termination letter on October 26, 2004, he did not take any inventory and was unable to testify regarding value.[9] Even assuming that the agreement between the parties required McGowan to return the sample candles to Soy Basics upon termination of the agreement, the Court's determination of value would be little more than speculation.

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[7]The portion set forth in Italics was handwritten into the contract at the time the Agreement was executed.

[8]The Court also notes that even if the 2004 agreement became effective and McGowan owed Soy Basics for samples provided, no additional samples were sent after the purported effective date of the 2004 agreement.

[9]It is undisputed that McGowan timely delivered the display hutches to Soy Basics' new sales representative, who was apparently located across the hall at the Columbus Marketplace.

In addition to its counterclaim for the cost of sample candles, Soy Basics claims that it is entitled to off-sets for a commission payment which was erroneously paid to McGowan and a reduction for bad debts. Ron Fish, Chief Financial Officer of Soy Basics, testified at trial that during the final accounting it was determined that a commission which was owed by Soy Basics to Company of Kings, in the amount of $1,232.94, was erroneously paid to McGowan. Also, Mr. Fish determined that an off-set for bad debts was appropriate in the amount of $2,097.97. McGowan did not offer any contrary evidence regarding these claims and the Court concludes that Soy Basics is entitled to an off-set totaling $3,330.91. Therefore, the net commissions owed by Soy Basics to McGowan is $13,174.62 less $3,330.91, or $9,843.71.

C. Is McGowan Entitled to Treble Damages?

As set forth above, the Court has concluded that the Sales Representative Agreement (Plaintiff's Exhibit 4) proposed in the summer of 2004 did not ripen into a valid contract. Accordingly, the provisions of Paragraph 12.1, which provided that "[t]his Agreement shall be governed by and construed in accordance with the laws of the State of Iowa," do not apply.[10] It is still necessary for the Court to determine, however, whether the Ohio statute is applicable in this case and, if so, whether McGowan is entitled to recover under the terms of the statute.

1. Does Ohio Revised Code Section 1335.11 apply?

In an action based upon diversity of citizenship jurisdiction, a federal district court must apply the substantive law of the state in which it sits, including its conflict-of-laws or choice-of-law rules. *Harlan Feeders, Inc. v. Grand Laboratories, Inc.*, 881 F. Supp. 1400, 1404 (N.D. Iowa 1995) (citing *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487 (1941)). *See also Ferens v. John Deere Co.*, 494 U.S. 516, 519 (1990) ("[U]nder *Klaxon*

[10]McGowan argues that Paragraph 12.1 only provided that the laws of the State of Iowa would be used to construe the agreement and, therefore, did not apply to its statutory claim for treble damages in any event. Given the Court's finding that the proposed 2004 agreement is not a binding contract, however, it is not necessary for the Court to reach that argument.

Co. v. Stentor Elec. Mfg. Co., 313 U.S. 487, 496, 61 S. Ct. 1020, 1021, 85 L. Ed. 1477 (1941), the federal court in the exercise of diversity jurisdiction must apply the same choice-of-law rules that [the forum] state courts would apply if they were deciding the case."). Accordingly, the Court must apply Iowa choice-of-law rules in determining whether Ohio law applies.

Iowa courts have adopted the "most significant relationship" test of the *Restatement (Second) of Conflict of Laws* for determination of conflict-of-laws questions pertaining to contract actions. *Harlan*, 881 F. Supp. at 1410. This view was summarized by the Iowa Supreme Court in *First Midwest Corp. v. Corporate Finance Associates*, 663 N.W.2d 888, 893 (Iowa 2003), as follows:

> Under well-recognized conflict of laws principles, "the rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties." *Restatement (Second) of Conflict of Laws § 188 (1971)*. "Significant relationship" is determined by reference to the place of contracting, place of performance, location of the contract's subject matter and the domiciles of the parties.

See also Bartels v. Wisconsin Mut. Ins. Co., 737 N.W.2d 326 (Table), 2007 WL 1828302 (Iowa App.). *The Restatement (Second) of Conflict of Laws* Section 188, which has been specifically adopted by the state court in Iowa, provides as follows:

> Law Governing in Absence of Effective Choice by the Parties
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> (1) The rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in § 6.
>
> (2) In the absence of an effective choice of law by the parties (see § 187), the contacts to be taken into account in applying the principles of § 6 to determine the law applicable to an issue include:

> (a) the place of contracting,
>
> (b) the place of negotiation of the contract,
>
> (c) the place of performance,
>
> (d) the location of the subject matter of the contract, and
>
> (e) the domicil, residence, nationality, place of incorporation and place of business of the parties.
>
> These contacts are to be evaluated according to their relative importance with respect to the particular issue.
>
> (3) If the place of negotiating the contract and the place of performance are in the same state, the local law of this state will usually be applied, except as otherwise provided in §§ 189-199 and 203.

Soy Basics argues that Iowa has the most significant relationship to the transaction. Soy Basics notes that the product is manufactured in Iowa and shipped throughout the United States. McGowan argues, on the other hand, that the "place of performance," i.e., the solicitation of sales, was primarily in Ohio.

The initial contact between the parties occurred when a representative of Soy Basics contacted McGowan at its place of business in Ohio and asked if it would be interested in representing Soy Basics. While the record is imprecise regarding where the "negotiation of the contract" occurred, there is no evidence that McGowan ever traveled to Iowa. Under the terms of the agreement, McGowan was required to solicit orders for Soy Basics products. To that end, McGowan maintained a showroom in Columbus, Ohio, and also solicited orders in Ohio and surrounding states. After considering all of these facts and circumstances, the Court concludes that Ohio, the state in which the contract was primarily performed, has the most significant relationship to the transaction. Accordingly, under the

Iowa choice-of-law rules, the substantive law of Ohio, including Ohio Revised Code Section 1335.11, is applicable.

2. Is McGowan Entitled to Recover Under Section 1335.11?

Ohio Revised Code § 1335.11(C) provides as follows:

> Upon the termination of a contract between a principal and a sales representative for the solicitation of orders for a product or orders for services, the principal shall pay the sales representative all commissions due the sales representative at the time of the termination within thirty days of the termination and shall pay the sales representative all commissions that become due after the termination within thirteen days of the date on which the commissions become due.

Soy Basics is a "principal" and McGowan is a "sales representative" as defined in §§ 1335.11(A)(2) and 1335.11(A)(3), respectively. Accordingly, pursuant to Section 1335.11(C), Soy Basics was required to pay McGowan all commissions due at the time the agreement was terminated, within thirty days of the termination. The evidence established, however, that Soy Basics did not tender payment of the commissions until shortly before trial, more than two and one-half years after they became due. This is despite the fact that Soy Basics admits that it owes at least $6,209.66 in unpaid commissions.

Section 1335.11(D) provides that if a principal fails to comply with the payment provisions set forth in division (C), then the principal

> is liable in a civil action for exemplary damages in an amount not to exceed three times the amount of the commissions owed to the sales representative if the sales representative proves that the principal's failure to comply with division (C) of this section or the contractual provision constituted willful, wanton, or reckless misconduct or bad faith.

Ohio Revised Code § 1335.11(D). Division (D) further provides that "[t]he prevailing party in an action brought under this section is entitled to reasonable attorney's fees and court costs."

Soy Basics notes that Section 1335.11 was found to be unconstitutional in *Johnson, MacDonald & Assoc. v. Webster Plastics*, 856 F. Supp. 1249 (S.D. Ohio 1994). At that time, Section 1335.11(A)(2) defined "principal" as any person "who does not have a permanent or fixed place of business in this state." The Court concluded that the statute discriminated on its face against "a class of non-Ohio manufacturers, to wit, those without a permanent or fixed place of business in Ohio." *Id.* at 1252. As noted by McGowan, however, Section 1335.11(A)(2) was amended in 1999 to remove the offending language. *See* 1999 Ohio Laws File 63(s.b. 18).[11] The Court believes that Section 1335.11, as amended, passes constitutional muster.[12]

It is clear that Soy Basics failed to comply with Section 1335.11(C), requiring the payment of all commissions due at the time of termination within thirty days of the termination. In order to justify an award of exemplary damages, however, McGowan must prove that Soy Basics' failure to timely pay commissions was "willful, wanton, or reckless misconduct or bad faith," in violation of Section 1335.11(D). These terms are not defined in the statute, nor was the Court able to find any Ohio cases addressing these terms in the context of Section 1335.11. Accordingly, the Court must review other cases considering these terms in other contexts.

In the context of a tort claim, "willful misconduct" has been defined to mean conduct involving "the intent, purpose, or design to injure." *Robertson v. Dept. of Public Safety*, 2007 WL 2800371 (Ohio App. 10 Dist.) at *3. "Wanton misconduct is a failure to exercise any care toward one to whom a duty of care is owed under circumstances in which there is a great probability that harm will result and the tortfeasor knows of that

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[11]The 1999 amendment also added language that requires a showing of "willful, wanton, or reckless misconduct or bad faith" in order to justify an award of exemplary damages.

[12]If the Court believed that the constitutionality of Section 1335.11 was seriously in dispute, then it would be required to certify that fact to the Attorney General of the State of Ohio and permit the State to intervene for argument on the question of constitutionality. 28 U.S.C. § 2403(b).

probability." *Id.* at *4. In a tort action against a government entity, the Court held that "'willful and wanton misconduct' constitutes more than mere negligence. (citation omitted) It is behavior which demonstrates 'a deliberate or reckless disregard for the safety of others.'" *Huffman v. Bd. of County Commissioners*, 2006 WL 1851715 (Ohio App. 7 Dist.) at *12. In its Supplemental Trial Brief (docket number 89), McGowan cites *Becker Equip., Inc. v. Flynn*, 2004 WL 486219 (Ohio App. 12 Dist.), a commercial tort case, for the proposition that "willful" means "voluntary and intentional, but not necessarily malicious." *Id.* at *4 (citing *Black's Law Dictionary* (7th ed.)).

In *Morton Bldgs., Inc. v. Correct Custom Drywall, Inc.*, 2007 WL 1641155 (Ohio App. 10 Dist.), the Court recognized that "bad faith" is "not susceptible to a concrete definition." *Id.* at *6. Citing *Hoskins v. Aetna Life Ins. Co.*, 452 N.E.2d 1315 (Ohio 1983), however, the Court noted that it

> embraces more than bad judgment or negligence. It imports a dishonest purpose, moral obliquity, conscious wrongdoing, breach of a known duty through some ulterior motive or ill will partaking of the nature of fraud. It also embraces actual intent to mislead or deceive another.

Id. at *6.

Ron Fish, Chief Financial Officer of Soy Basics, admitted at the time of trial that most of the information necessary to determine the amount owed to McGowan was available in November 2004. According to the testimony of Mr. Nicolaisen and Mr. Fish, a spreadsheet containing a detailed accounting of the amount owed, including the off-sets claimed by Soy Basics, was completed in October 2005. That is, Soy Basics knew nearly two years prior to trial that the total commissions owed, before taking any off-sets or credits, was $13,174.62. Even if Soy Basics received all of its claimed off-sets, including $3,884.05 for "display and candle charges," it knew that it owed McGowan not less than $6,209.66.

In response to McGowan's Second Request for Admissions, served January 2, 2007, Soy Basics admitted that even after deducting any off-sets or credits represented by its

counterclaim, Soy Basics still owed McGowan $6,209.66. (*See* Plaintiff's Exhibit 8.) Payment in that regard was not tendered until shortly before trial, however, approximately two and a half years after the payment was due. The Court concludes that Soy Basics' failure to pay commissions which it knew it owed to McGowan was intentional and, therefore, "willful." The Court also concludes that Soy Basics deliberately disregarded McGowan's right to payment, thereby constituting "wanton misconduct." Finally, the Court concludes that Soy Basics' failure to pay amounts which it admittedly owed constituted "bad faith."

Since Soy Basics' failure to timely pay the commissions constituted "willful, wanton, or reckless misconduct or bad faith," Soy Basics is liable for exemplary damages "in an amount not to exceed three times the amount of the commissions owed." Ohio Revised Code Section 1335.11(D). The "not to exceed" language contained in the statute gives the finder of fact discretion to impose those exemplary damages which are justified after considering all of the facts. Given Soy Basics' admission that it owes at least $6,209.66, and considering the length of time which has expired since the commissions became due and owing, the Court concludes that Soy Basics should be required to pay exemplary damages equal to three times the amount of commissions which it admits that it owed. That is, the Court finds that Soy Basics should pay exemplary damages in the amount of $18,628.98, representing three times the amount which it admits that it owed after any potential off-sets or credits.

D. Summary

In summary, the Court concludes that McGowan has met its burden of proving that Soy Basics breached the parties' agreement for the payment of commissions in exchange for services. Pursuant to the stipulation of the parties, Soy Basics owes McGowan Thirteen Thousand One Hundred Seventy-Four Dollars and sixty-two cents ($13,174.62) for unpaid commissions. The Court further concludes that Soy Basics has established its entitlement to a credit for the Company of Kings commission and bad debts, totaling Three Thousand Three Hundred Thirty Dollars and ninety-one cents ($3,330.91). Therefore, the

net commissions owed to McGowan is Nine Thousand Eighty Hundred Forty-Three Dollars and seventy-one cents ($9,843.71). In addition, the Court finds that Soy Basics is liable to McGowan for exemplary damages in the amount of Eighteen Thousand Six Hundred Twenty-Eight Dollars and ninety-eight cents ($18,628.98). Therefore, the total amount owed to McGowan by Soy Basics is Twenty-Eight Thousand Four Hundred Seventy-Two Dollars and sixty-nine cents ($28,472.69). Rather than enter judgment for that amount at this time, however, the Court finds that a hearing should be held to determine the reasonable attorney's fees which should be assessed pursuant to Ohio Revised Code Section 1335.11(D).

V. ORDER

IT IS THEREFORE ORDERED that this matter shall come on for hearing in the second floor courtroom, United States District Courthouse, Cedar Rapids, Iowa, on **DECEMBER 10, 2007, 9:00 a.m.** for the purpose of allowing evidence and argument regarding the issue of attorney's fees.

DATED this _____ day of November, 2007.

_____
JON STUART SCOLES
United States Magistrate Judge
NORTHERN DISTRICT OF IOWA